

# Budget imbalance

*Rising medical costs could throw off the ecology of government*

BY ERIC KRISS

When we speak of balance in government, the typical reference is either to the intricate separation of powers inherent in our constitutional democracy, or to the fiscal requirement of a balanced budget. Questions of balance, then, are usually left to the political scientist or fiscal officer, and are of secondary importance to most citizens. I would like to explore a third aspect of governmental balance that we should be concerned about, this time in an ecological context.

A primary issue in ecology is sustainability (or the lack thereof) of the natural system under study. Ecologists honor endurance—that is, species survival—as the critical objective. We also honor endurance in government. We are justly proud to be part of the oldest continuously functioning constitutional democracy in the world, right here in Massachusetts. July 4th marks the annual celebration of our American experiment.

Endurance does not mean stasis, a dead world without change. We expect dynamic changes and anticipate adapting to them. But how do we know whether each new development can be sustained?

The French biologist Jean Rostand said, “The obligation to endure gives us the right to know.” This powerful idea inspired a chapter in Rachel Carson’s *Silent Spring*, the book that popularized the ecological movement in America. Exercising our right to know depends on asking the right questions.

A little history lesson is instructive here. Almost everyone viewed the significant “dust bowl” warming in the United States during the 1930s as a mild natural cycle of unknown origin. The one exception was G.S. Callendar, a steam engineer, who wrote a 1938 British journal article that described a potential link between carbon dioxide gas and a greenhouse-like warming in the atmosphere. If Callendar was correct, rising temperatures would result in an ecological imbalance. Everyone ignored him.

Callendar’s idea eventually attracted some government funding—especially from the military, which was interested in adaptive weather tactics—for studies that showed carbon dioxide could build up in the atmosphere and trigger warming. In 1961, scientific instruments showed

that the level of CO<sub>2</sub> was indeed rising each year, but no direct link to temperature was made. *Silent Spring* was published the next year.

By 1967, some speculated that average temperatures might rise a little over a century or so, but scientific concern remained low. During the 1970s, the mass media confusingly predicted both global flooding as the ice caps melted, and the possibility of a catastrophic new Ice Age. The scientific community reached no consensus.

The record hot summer of 1988 focused public concern. Greatly improved computer models began to suggest more rapid jumps in temperature. In 1992, international discussion of global warming was embodied in the agreements that led to the Kyoto Protocol. Scientific debate on the causes and extent of global warming continues to this day, but it is now an issue that no one—in the scientific community or the broader community—can ignore.

I recount this history to point out that ecological issues take a long time to surface. Defining them requires a con-

## Are human service programs squeezing out other needs?

certed and serious quantitative effort, and it depends on asking the right questions.

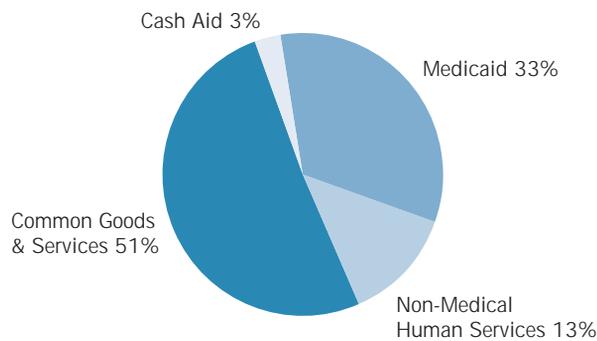
My examination of Massachusetts state spending trends (as documented by the US Bureau of the Census, which tracks spending over time more consistently than state budget accounts) leads me to ask some very difficult ones. Is the growth in health and human service programs—driven by obvious needs we all care about—causing a kind of fundamental imbalance in our governmental affairs? Are these problems squeezing out other needs and/or crimping economic growth by consuming an ever-larger share of our incomes? Or are we witnessing just a mild natural cycle of unknown cause, as everyone but G.S. Callendar thought back in the 1930s?

Today, state government pursues two fundamental missions: 1) aiding those unable to pay for the basic necessities of life, and 2) providing the infrastructure and shared services that form the fabric of our society, like

roads, schools, parks, police, and courts.

This year in Massachusetts almost half of state spending aids the needy, while the other half is devoted to public goods and services shared by all. Most assistance the state gives to the needy is handled indirectly through payments to providers for medical care and nursing homes, primarily through Medicaid (also known as MassHealth). Public health and social service spending account for the next largest portion. In 2004, only 3 percent of state dollars went directly to individuals as cash payments.

### 2004 Spending: Health & Welfare vs. All Other



Does this division—state spending roughly split down the middle between services to the needy and functions that serve us all in common—reflect a natural balance between basic functions of government? Can we expect to maintain it? Or are we quietly, but dynamically, chang-

ing the mix of basic governmental missions in a way that threatens to be unsustainable going forward?

Within the services provided to the needy, a shift is well underway—indeed, almost complete (see Fig. 1). In 1977, direct cash assistance and provider payments were nearly identical in scale, each representing 16 percent of state spending. From there, cash assistance began a long, 25-year slide, interrupted only by the 1990-92 recession. Meanwhile, vendor payments held relatively steady for a decade up to a significant escalation in 1990-91, followed by another stable decade at a level of roughly 23 or 24 percent of the state budget.

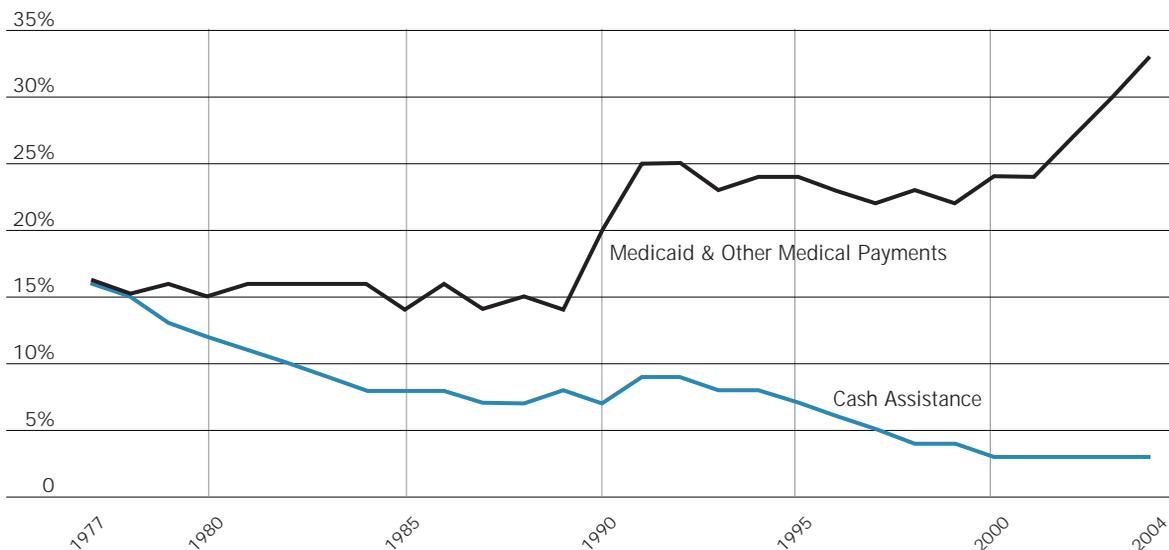
Since 2001, however, we have witnessed a jump similar to the last recessionary period. State spending on medical care for the needy crossed the 30 percent threshold in 2003, and is at 33 percent of state expenditures this year.

Is this leap in medical payments a function of a decade-long cycle? Should we expect a slight decline over the decade ahead, as a new equilibrium settles in? Or is the recent upward movement evidence of unsustainable cost growth, driven by an aging population, new technology, or other unknown factors? And if so, what does that mean for the long-term balance between the two core missions of state government? In other words, what does it mean for the ecology of government?

### TWO SCENARIOS

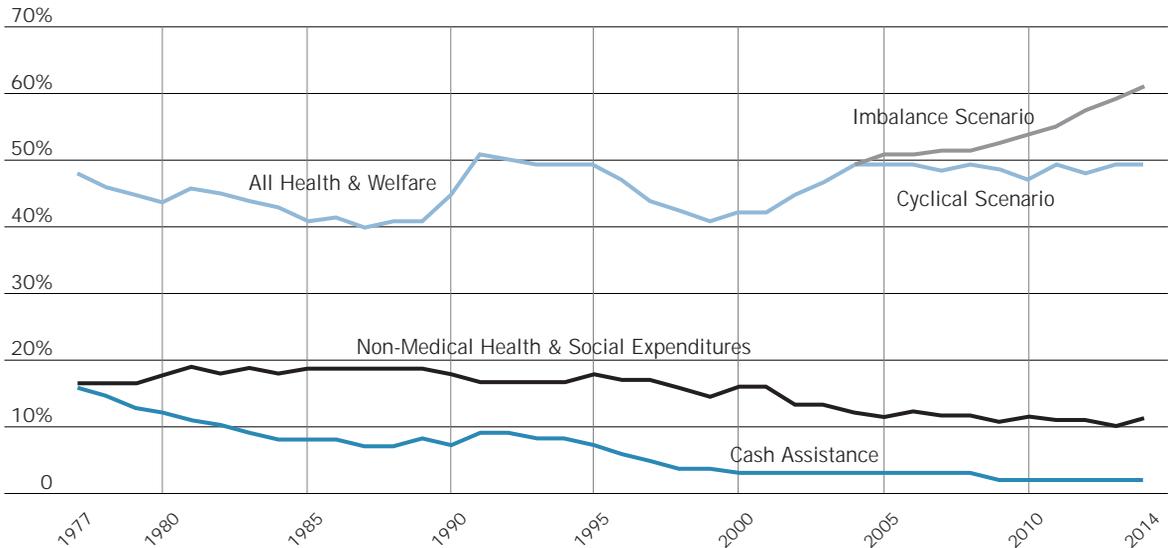
It is possible to project the Commonwealth's spending mix into the future according to two different scenarios (see Fig. 2). Each scenario has implications for the eco-

FIGURE 1: Medicaid and Public Assistance (Percent of State Budget)



Source: US Bureau of the Census and Mass. Executive Office for Administration and Finance

**FIGURE 2: Spending Scenarios: Cyclical vs. Imbalance**



Source: US Bureau of the Census and Mass. Executive Office for Administration and Finance

gy of government services. But one is less troubling than the other.

If we forecast a slight decline in the share of state spending going to medical care and nursing home payments for the next decade, similar to the 1990s, we reach a new balance, albeit at levels reached only during previous peaks in the cycle. That would mean the balance between the two fundamental missions of caring for the needy and meeting common needs would stay roughly where it is in 2004. Any new initiatives—in education, environment, housing, or transportation, for example—would have to be accommodated within the current share (half) of total state spending (which would, of course, generally grow with the overall economy).

Now let's turn to the alternative scenario, one that I consider a scenario of imbalance in the making. Here we see no equilibrium reached, as medical and nursing home payments continue to escalate. At this point, cash assistance is too small for any further declines to offset this expansion of medical spending. Even with other, non-medical social-service programs for the needy remaining under 15 percent of state spending, as they are now, after a decade, the mix between the two fundamental missions of government would shift from today's roughly 50-50 balance, with functions shared by all citizens declining below half of total spending. In order to accommodate this growth in medical payments, services shared by all citizens would have to shrink as a portion of the state budget. This imbalance scenario raises obvious questions about sustainability.

## GOVERNMENT AND THE ECONOMIC ECOSYSTEM

Of course, there is another possibility. What about raising taxes? Why not simply increase the size of government relative to the private sector in order to satisfy the new demands of the public assistance mission?

Viewing government from an ecological perspective, taxes do not exist in a vacuum. Tax policy is part of our economic ecosystem, as well as our government ecology, and it contributes to the dynamic balance between job growth and decline. Again, a look at history is helpful.

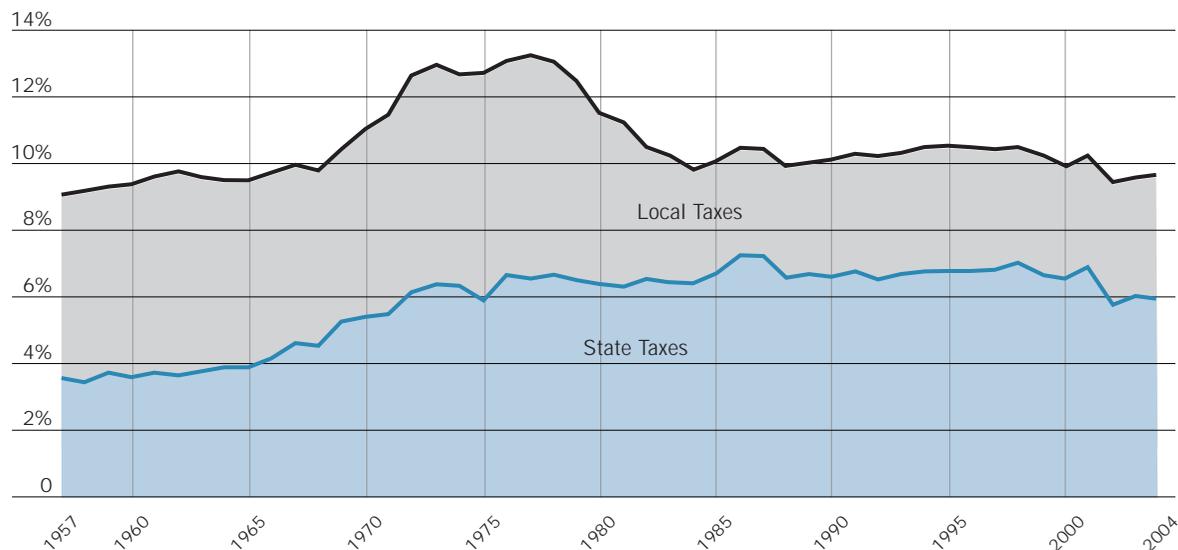
State and local taxation has been relatively stable—hovering around 10 percent of personal income—for 40 years (see Fig. 3). Proposition 2½, which was fully implemented by the early 1980s, corrected for a spike in taxes that occurred in the mid-to-late-1970s. Currently, we have still not emerged fully from the latest economic downturn, which has had a significant impact on state tax revenue. But the important thing is the long-term stability in the share of Massachusetts income taken by state and local taxes, a stability that can be seen despite hundreds of tax law changes during this period, including:

- income tax rates that went from 5 percent to 6.25 percent and then back down to 5.3 percent;
- cigarette tax rates that rose 800 percent; and
- gas tax rates that rose 150 percent.

In fact, the only tax change even visible on this time scale is Prop. 2½, which only impacted local real estate taxes.

Stability also implies a central fact of governmental budgets: Over the long term, budgetary spending tracks

FIGURE 3: State and Local Taxes (Percent of Personal Income)



Source: US Bureau of the Census and Mass. Executive Office for Administration and Finance

economic growth. From an ecological viewpoint, we should be concerned with economic growth rates, not with tax rates. We should also be thankful that this government share has remained stable, for the past 20 years have witnessed a remarkable revitalization of a once-stagnant state economy. A fluctuating governmental share would certainly have impeded robust job growth.

Our modern capitalist system is like a complex biosphere, influenced by multiple factors, such as tax burdens, housing costs, transportation infrastructure, concentrations of educated workers, and climate. To grow, we need to accentuate the positive and minimize the negative. In this context, a move to raise taxes would threaten the long-term balance on which we all rely.

Looking at historical data, we can reasonably expect income growth (in nominal terms) to average around 5 percent. We have a state law that sweeps any “excess” revenue due to inflation into a rainy day fund, so 4 percent is a realistic growth expectation for our state budget.

These assumptions regarding economic growth (and government’s share of that growth), put together with the two different scenarios I’ve projected, have implications for the governor’s fiscal 2005 budget and beyond. Overall, we might expect a 4 percent increase in spending next year. However, the mix change I have described puts the major government missions in direct competition for resources. And that competition is likely to get worse.

If, over time, we experience an unsustainable escalation in medical and nursing home payments, then fund-

ing for the rest of government will have to decline. For schools, parks, subways, and roads, each year will be harder than the previous one. Meanwhile, cost pressures on the health-and-human-services side will collide with the natural growth rate of the underlying economy. This will mean continuing budget shortfalls—and cuts.

A cyclical scenario offers, perhaps, a slightly more optimistic assessment. A new equilibrium will emerge, but with the public goods mission of government permanently downsized to a level only seen once or twice before in the state’s history. In either case, we will have to make better use of existing resources.

**E**cological issues take a long time to surface and even longer to understand. The ecology of government is no different. It is too soon to tell whether unsustainable medical and nursing home costs would need to be addressed by narrowing eligibility, reducing benefits, or other remedies we haven’t yet contemplated. But the longer we wait to think about these issues, the more painful the remedies will be.

In *Silent Spring*, Rachel Carson defended the perspective of nature:

*In some quarters nowadays it is fashionable to dismiss the balance of nature as a state of affairs that prevailed in an earlier, simpler world—a state that has now been so thoroughly upset that we might as*

*well forget it. Some find this a convenient assumption, but as a chart for a course of action it is highly dangerous. The balance of nature is not the same today as in Pleistocene times, but it is still there: a complex, precise, and highly integrated system of relationships between living things which cannot safely be ignored any more than the law of gravity can be defied with impunity by a man perched on the edge of a cliff. The balance of nature is not a status quo; it is fluid, even shifting, in a constant state of adjustment.*

I think this logic applies to our governmental affairs as well. It is tempting to dismiss the notion of the long-run balance between government and the private sector as a relic from some simpler American era. It is easy to ignore the mix changes we see in government missions.

But we cannot do so with impunity. The obligation to endure gives us the right to know, and exercising that right requires that we ask the right questions, no matter how difficult they may be. ■

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